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No. 07-

IN THE

Supreme Court of the United States

CIRCUIT CITY STORES, INC.,

Petitioner,

v.

ROBERT GENTRY,

Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of California

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the Federal Arbitration Act permits a court to refuse to enforce an agreement calling for individual arbitration based on state labor law policies that do not apply generally to "any contract." 9 U.S.C. § 2.

2. Whether the Federal Arbitration Act permits a state court to refuse to enforce an agreement to arbitrate based upon an unconscionability analysis "that takes its meaning precisely from the fact that a contract to arbitrate is at issue." *Perry* v. *Thomas*, 482 U.S. 483, 492 n.9 (1987).

LIST OF PARTIES AND AFFILIATES

The parties to the proceeding are set forth in the caption to this Petition.

Pursuant to Rule 29.6 of the Rules of this Court, petitioner Circuit City Stores, Inc. states that it has no parent corporation and that no publicly held company owns more than 10 percent petitioner's publicly traded stock.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner Circuit City Stores, Inc. ("Circuit City") respectfully requests that this Court grant the petition for a writ of certiorari to review the decision and judgment of the California Supreme Court.

OPINIONS BELOW

The opinion of the California Supreme Court is reported at 165 P.3d 556 (Cal. 2007) and is reproduced in the Appendix to this Petition ("Pet. App.") at 1a to 55a. The California Supreme Court's denial of rehearing is unpublished and appears at Pet. App. 81a. The decision of the California Court of Appeal, Second Appellate District, Division Five, compelling arbitration appears at Pet. App. 56a-64a. The decision of the California Superior Court compelling arbitration appears at Pet. App. 75a-80a.

JURISDICTION

The California Supreme Court entered judgment on August 30, 2007, Pet. App. 1a, and denied a petition for rehearing on October 31, 2007, *id.* at 81a. This Court has jurisdiction over this petition for certiorari under 28 U.S.C. § 1257(a). Although the decision of the California Supreme Court envisions further proceedings in the lower courts, this Court has jurisdiction to review such judgments. See, *e.g.*, *Southland Corp.* v. *Keating*, 465 U.S. 1, 6-7 (1984); *Perry* v. *Thomas*, 482 U.S. 483, 489 n.7 (1987).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Article VI, Clause 2 of the United States Constitution provides in pertinent part:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Section 2 of the Federal Arbitration Act, 9 U.S.C. § 2, provides in pertinent part:

> A written provision in any . . . contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist in law or equity for the revocation of any contract.

Section 1194 of the California Labor Code is reproduced in the Appendix at Pet. App. 82a.

STATEMENT OF THE CASE

This case presents issues of surpassing importance concerning the proper application of the Federal Arbitration Act ("FAA"). Respondent Robert Gentry was employed by Circuit City and later voluntarily agreed to resolve all employment disputes he might have with Circuit City through individual arbitration. He was given the opportunity to opt out of Circuit City's arbitration program, but declined to do so. Thereafter, Respondent ignored his agreement to arbitrate and instead filed a class action in state court claiming entitlement to overtime pay for himself and a class of other employees.

Both the California Superior Court and Court of Appeal applied generally applicable contract rules and held that Respondent must arbitrate his claims individually. In the decision below, the California

Supreme Court reversed and, in doing so, interposed two unlawful barriers to the enforcement of arbitration agreements that implicate broad conflicts with contrary federal circuit decisions and that cannot be reconciled with this Court's decisions.

First, the California Supreme Court refused to enforce the parties' agreement to arbitrate in accordance with its terms and remanded the case for an evaluation whether individual arbitration was consistent with California labor law. Pet. App. 23a, 41a. Conditioning enforcement of an arbitration agreement on compliance with state labor law runs contrary to Section 2 of the FAA, which provides that agreements to arbitrate are enforceable save upon grounds available for the "revocation of any contract." 9 U.S.C. § 2.

The California Supreme Court's contrary conclusion conflicts directly with the decisions of the Ninth Circuit and federal courts of appeals across the country. See *Bradley* v. *Harris Research, Inc.*, 275 F.3d 884, 889-90 (9th Cir. 2001); *Stawski Distrib. Co.* v. *Browary Zywiec S.A.*, 349 F.3d 1023, 1024-26 (7th Cir. 2003); *OPE Int'l LP* v. *Chet Morrison Contractors, Inc.*, 258 F.3d 443, 447 (5th Cir. 2001) (per curiam); *KKW Enters., Inc.* v. *Gloria Jean's Gourmet Coffees Franchising Corp.*, 184 F.3d 42, 50-51 (1st Cir. 1999); *Doctor's Assocs., Inc.* v. *Hamilton*, 150 F.3d 157, 163 (2d Cir. 1998); *cf. Management Recruiters Int'l* v. *Bloor*, 129 F.3d 851, 856 (6th Cir. 1997). These courts, applying Section 2 of the FAA and this Court's decisions in *Southland* and *Perry*, have held that agreements to arbitrate cannot be avoided based upon narrow state-law policies that do not apply generally to "any contract." The decision below thus interposes a barrier to arbitration that cannot be reconciled with these conflicting decisions.

Second, the California Supreme Court also violated the FAA when it reversed the Court of Appeal's and Superior Court's determination that the parties' agreement to arbitrate was not unconscionable. The California Supreme Court held that the arbitration agreement was "procedurally unconscionable" because even though Circuit City disclosed to Gentry the rules that would govern arbitration and explained "some of the shortcomings of arbitration," it "did not mention any of the additional significant disadvantages that *this particular arbitration agreement had compared to litigation.*" Pet. App. 37a (emphasis added).

That ruling conflicts with the FAA and this Court's decisions holding that a court may not refuse enforcement based upon state-law principles that are hostile to arbitration or depend on the fact that an arbitration agreement is at issue. See *Perry* v. *Thomas*, 482 U.S. 483, 492-93 n.9 (1987); *Doctor's Assocs., Inc.* v. *Casarotto*, 517 U.S. 681, 687 (1996). Further, the decision below conflicts with the Third Circuit's conclusion that state unconscionability standards are preempted by the FAA when they take their meaning from the fact that an agreement to arbitrate is at issue. See *Gay* v. *CreditInform*, __ F.3d ___, 2007 WL 4410362 (3d Cir. Dec. 19, 2007). Resolution of this conflict is even more important now that the Ninth Circuit has weighed in and declined "to follow the holding in *Gay*." *Lowden* v. *T-Mobile USA, Inc.*, ___ F.3d ___, 2008 WL 170279, at *8 n.3 (9th Cir. Jan. 22, 2008).

Review is warranted to resolve these mature and persistent conflicts between the decision of the California Supreme Court and the decisions of this Court and federal courts of appeals interpreting the requirements of the FAA. As explained by the

dissenting justices, the decision of the California Supreme Court undermines the benefits of arbitration by "alter[ing] the arbitral terms to which the parties agreed, and defeat[ing] the essential purposes and advantages of arbitration, by transforming that process, against the parties' expressed will at the time they entered the agreement, into something more and more like the court litigation arbitration is intended to avoid." Pet. App. 52a (Baxter, J., dissenting).

STATUTORY BACKGROUND

Section 2 of the FAA reflects "a congressional declaration of a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary." *Moses H. Cone Mem'l Hosp.* v. *Mercury Constr. Corp.*, 460 U.S. 1, 24-25 & n.32 (1983). Congress enacted the FAA in response "to hostility of American courts to enforcement of arbitration agreements." *Circuit City Stores, Inc.* v. *Adams*, 532 U.S. 105, 111 (2001). The "primary purpose" of the FAA is "ensuring that private agreements to arbitrate are enforced according to their terms." *Volt Info. Scis., Inc.* v. *Board of Trs.*, 489 U.S. 468, 479 (1989). Under the FAA, "questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration" and "any doubts concerning" a "defense to arbitrability" "should be resolved in favor of arbitration." *Moses H. Cone*, 460 U.S. at 24-25.

"[B]y agreeing to arbitrate, a party 'trades the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration.'" *Gilmer* v. *Interstate/ Johnson Lane Corp.*, 500 U.S. 20, 31 (1991). Indeed, "it is typically a desire to keep the effort and expense

required to resolve a dispute within manageable bounds that prompts [parties] to forgo access to judicial remedies." *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 633 (1985). As this Court has explained, enforcement of arbitration agreements provides "real benefits" in the "employment context," which "often involves" disputes over "smaller sums of money." *Adams*, 532 U.S. at 122-23; accord *Gilmer*, 500 U.S. at 24.

In Section 2 of the FAA, Congress limited the substantive grounds available for refusing to enforce an agreement to arbitrate to "grounds as exist at law or in equity for the revocation of any contract.'" *Perry* v. *Thomas*, 482 U.S. 483, 489 (1987) (quoting 9 U.S.C. § 2); accord *Southland Corp.* v. *Keating*, 465 U.S. 1, 10-11 (1984). Congress "intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements" based on state laws that do not provide a basis for the revocation of "*any* contract.'" *Id.* at 16 n.11 (quoting 9 U.S.C. § 2). The FAA's preemptive effect extends to state laws of "judicial origin" so that a "state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with . . . § 2." *Perry*, 482 U.S. at 492-93 n.9; *Doctor's Assocs., Inc.* v. *Casarotto*, 517 U.S. 681, 687 (1996) ("Courts may not . . . invalidate arbitration agreements under state laws applicable only to arbitration provisions").

FACTUAL BACKGROUND

a. In March 1995, Respondent Robert Gentry was employed by Circuit City as a Customer Service Manager. On March 29, 1995, Gentry attended a presentation about Circuit City's "Associate Issue Resolution Program ("AIRP"). That presentation

included a video and written materials describing the AIRP. Following the video presentation, Respondent signed a form confirming that he (i) had watched the video, (ii) had received copies of the explanatory materials, and (iii) had received a "Circuit City Arbitration Opt-Out Form." See Cal. S. Ct. Exhibits In Support of Petition for Writ of Mandate and/or Prohibition ("Cal. Exhs.") at 38. Gentry was advised that he should review these materials, consult with Circuit City or seek to consult with an attorney regarding Circuit City's arbitration proposal. *Id.* Respondent was given 30 days to decide whether to opt out of the arbitration agreement, and could do so simply by returning a one-page form. *Id.* Gentry chose not to do so. *Id.* at 35-36.

Respondent instead agreed to be bound by the Dispute Resolution Agreement ("Agreement"). The Agreement provides that "any and all employment-related legal disputes, controversies or claims arising out of, or relating to an Associate's . . . employment or cessation of employment with Circuit City . . . shall be settled exclusively by final and binding arbitration." *Id.* at 63, Agreement, Rule 2. As relevant here, the Agreement provides that "[t]he Arbitrator shall not consolidate claims of different Associates into one proceeding, nor shall the Arbitrator have the power to hear a class action." *Id.* at 68, Rule 9(f)(ii). Finally, the "Agreement and any award rendered pursuant to it shall be enforceable and subject to the Federal Arbitration Act, and the Uniform Arbitration Act of Virginia, regardless of the State in which the arbitration is held or the substantive law applied in the arbitration." *Id.* at 70, Rule 16 (citations omitted).

b. On August 29, 2002, Robert Gentry ignored his Agreement to arbitrate with Circuit City and instead

filed a class action in Superior Court of California. Gentry alleged that the "monetary damages sought" by plaintiff and "on behalf of each and every member of the class" exceeded the $25,000 "minimal jurisdiction limits of the Superior Court." Compl. ¶ 1; Cal. Civ. Proc. Code §§ 85, 88.

Gentry sought to represent "[a]ll California salaried customer service managers who worked overtime for [Circuit City] and were not paid overtime wages from within the four years preceding the filing of this complaint and up to the time defendants re-classified the position to non-exempt status." Compl. ¶ 11. Gentry advanced causes of action under Section 1194 of the California Labor Code, Section 17200 of the California Business and Professions Code, and common law conversion. *Id.* ¶¶ 10, 20, 24. In connection with these claims, Gentry sought recovery of (i) compensatory damages, (ii) "waiting time penalties" under California Labor Code § 203, (iii) "restitution and disgorgement of monies" under § 17200, (iv) "punitive and exemplary damages" for conversion, (v) "pre-judgment interest as allowed by California Labor Code Sections 1194 and 218.6," and (vi) "reasonable attorneys fees, expenses and costs provided by California Labor Code Sections 1194," and "other applicable California laws." Compl. at 14-15.

c. On February 28, 2003, the Superior Court granted Circuit City's motion to compel arbitration and ordered "plaintiff to arbitrate his claims on an individual basis." Pet. App. 75a. The court held that the agreement to arbitrate was not unconscionable because "Gentry was given the option of opting out of the arbitration agreement" but he "did not opt out." *Id.* at 79a.

The California Court of Appeal dismissed Gentry's appeal and subsequently denied his petition for writ of mandate. Pet. App. 72a. On November 19, 2003, the California Supreme Court granted Gentry's petition for review, and deferred further action pending its decision in *Discover Bank* v. *Superior Court*. *Id.* at 4a. On August 31, 2005, the California Supreme Court remanded this case to the Court of Appeal for reconsideration in light of its ruling in *Discover Bank*. *Id.* at 67a. On remand, the Court of Appeal again enforced the agreement to arbitrate because the "class action waiver" in the arbitration agreement "is neither procedurally nor substantively unconscionable." *Id.* at 59a.

The Court of Appeal explained that "the agreement at issue here does not have [an] adhesive element and therefore is not procedurally unconscionable" because "[s]igning the arbitration agreement was not made a condition of Gentry's employment" and "he was given 30 days to decide whether or not to opt out of the agreement, and chose not to do so." Pet. App. 61a. As such, Gentry was "free to decide whether or not the advantages of arbitration outweigh the disadvantages." *Id.* at 62a. The Court of Appeal distinguished *Discover Bank* because the Agreement was not a "'consumer contract of adhesion'" and did not "'predictably involve small amounts of damages.'" *Id.* at 63a. The court underscored that "Gentry has alleged statutory violations that could result in substantial damages and penalties should he prevail on his individual claims." *Id.* at 64a.

d. The California Supreme Court reversed. It concluded that enforcement of the parties' agreement to arbitrate individually turned on an evaluation of whether individual arbitration "would pose a serious obstacle to the enforcement of the state's overtime

laws." Pet. App. 1a. Specifically, the court ruled that "the statutory right to receive overtime pay embodied in section 1194 [of the California Labor Code] is unwaivable," *id.* at 12a, and that "under some circumstances [a provision requiring individual arbitration] would lead to a de facto waiver and would impermissibly interfere with employees' ability to vindicate unwaivable rights and to enforce the overtime laws," *id.* at 13a.[1]

The California Supreme Court held that enforcement of an agreement to arbitrate individually was contingent on an assessment whether a class action "is likely to be a significantly more effective practical means of vindicating the rights of the affected employees than individual litigation or arbitration" and whether "disallowance of the class action will likely lead to a less comprehensive enforcement of overtime laws for the employees alleged to be affected by the employer's violations." Pet. App. 23a. That inquiry would require a court to assess factors such as (i) "the potential for retaliation against members of the class," (ii) "the fact that absent members of the class may be ill informed of their rights," and (iii) a catch-all category encompassing "other real world obstacles to the vindication of class members' right to overtime pay through individual arbitration." *Id.* The court noted that this inquiry is "similar to the one [a court]

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[1] The court, however, ruled that "nothing in this opinion" prevents an employee from "entering into an individual *postdispute* arbitration agreement with Circuit City." Pet. App. 31a n.9 (emphasis added).

already makes to determine whether class actions are appropriate." *Id.* at 24a-25a.[2]

The court below rejected the argument that the FAA foreclosed its ruling. Pet. App. 26a-29a. The court acknowledged that the "United States Supreme Court has since held that the FAA does not permit states *to legislatively* prohibit arbitration of wage disputes," *id.* at 29a n.8 (emphasis added), but concluded that the FAA did not prohibit the court's refusal "to enforce, under some circumstances and in an arbitration-neutral manner . . . , provisions of arbitration agreements that significantly undermine the ability of employees to vindicate their statutory right to overtime pay." *Id.*

Separately, the California Supreme Court held that the agreement to arbitrate was procedurally unconscionable because although Circuit City "alluded to some of the shortcomings of arbitration in a general sense, it did not mention any of the additional significant disadvantages that *this particular arbitration agreement* had compared to litigation." Pet. App. 37a. Likewise, the court speculated that "it is not clear that someone in Gentry's position would have felt free to opt out." *Id.* at 39a.

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[2] The court dismissed the argument that "Gentry as an individual has not shown himself to be burdened by the class arbitration waiver" because it reasoned that "it makes little sense to focus only on whether the class representative himself or herself would be stymied in the pursuit of an individual arbitration remedy, rather than considering as well the difficulties for the class of employees affected by Circuit City's allegedly unlawful practices." Pet. App. 24a n.7 (citation omitted).

e. Justice Baxter, joined by Justices Chin and Corrigan, dissented. They explained that "there is no indication in the record that Gentry himself—the person whose contract for individual arbitration is actually before us—cannot, as a practical matter, vindicate his statutory overtime rights except through class proceedings." Pet. App. 46a. They highlighted that the practical impact of the majority's ruling was that notwithstanding an agreement to arbitrate individually, "the trial court may certify a class, in an overtime-wage case, *in any circumstance where it could otherwise do so.*" *Id.* at 47a.

The dissenters objected because the majority impermissibly "elevate[d] a mere judicial affinity for class actions as a beneficial device for implementing the wage laws above the policy expressed by . . . Congress . . . . that voluntary individual agreements to arbitrate—by which parties *give up* certain litigation rights and procedures *in return for* the relative speed, informality and cost efficiency of arbitration—should be enforced according to their terms." Pet. App. 48a-49a. The dissent explained that the majority had manifested its hostility to arbitration by "alter[ing] the arbitral terms to which the parties agreed, and defeat[ing] the essential purposes and advantages of arbitration, by transforming that process, against the parties' expressed will at the time they entered the agreement, into something more and more like the court litigation arbitration is intended to avoid." *Id.* at 52a.

Finally, the dissent would have affirmed the Court of Appeal's ruling that the Agreement was not procedurally unconscionable because "Circuit City provided Gentry, and other employees, with an extensive orientation about the program, then

allowed them a reasonable time to 'opt out.' without penalty simply by mailing back a form." Pet. App. 53a. They reasoned that because Gentry was afforded reasonable time to consult an attorney about the program, there was no basis for concluding that Circuit City misled its employees and there was no "evidence that it implied, threatened, or imposed any sanction for an employee's decision to opt out of the program." *Id.* at 55a.

REASONS FOR GRANTING THE PETITION

Review of the decision of the California Supreme Court is necessary to ensure the proper and uniform interpretation of the Federal Arbitration Act. This case presents an ideal vehicle to do so because the decision below squarely implicates conflicts among the federal courts on two recurring issues of national importance concerning the FAA. First, may courts refuse to enforce the terms of agreements to arbitrate based on narrow state policies that do not apply to "any contract" when the FAA mandates a "'liberal federal policy favoring arbitration agreements, notwithstanding state substantive or procedural policies to the contrary.'" *Perry* v. *Thomas*, 482 U.S. 483, 489 (1987) (quoting *Moses H. Cone Mem'l Hosp.* v. *Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983)). And, second, does the FAA allow arbitration-specific rules of unconscionability to provide a basis for refusing to enforce the terms of arbitration agreements. *Perry*, 482 U.S. at 492 n.9.

As to the first issue, under the decision below, enforcement of the terms of agreements to arbitrate can be denied not only on the narrow textual grounds set forth in Section 2 for the "revocation of any contract," 9 U.S.C. § 2, but also based upon countless policy preferences interposed by state legislatures

and courts in connection with virtually any substantive legal area from franchising law to consumer law to labor law. The decision below thus sets a dangerous precedent that threatens to undermine the benefits of arbitration under the FAA. Indeed, the FAA is predicated on the view that arbitration is valuable because it provides an alternative to litigation whereby parties can agree to resolve disputes through procedures that differ from those in litigation.

In adopting a broad view of the role that state policies should play in determining when the terms of arbitration agreements will be enforced, the California Supreme Court brought itself into conflict with decisions of five federal circuit courts – including the Ninth Circuit – which have held that agreements to arbitrate are fully enforceable save upon the textual grounds reflected in 9 U.S.C. § 2. Here, the California Supreme Court conditioned enforcement of the parties' agreement to arbitrate on an analysis whether individual arbitration was consistent with California labor law policies. That ruling is flatly inconsistent with the rule adopted by the federal circuits that have addressed this issue. See *supra* at 3. Indeed, the need for review is particularly stark because the decision below conflicts with the Ninth Circuit's decision in *Bradley* so that the requirements of the FAA in California depend on whether a case is pending in federal or state court.

As to the second issue, the California Supreme Court's separate "unconscionability" ruling likewise warrants review because it conflicts directly with the decisions of this Court explaining that enforcement of agreements to arbitrate cannot be predicated on a state-law principle that "takes its meaning precisely from the fact that an agreement to arbitrate is at

issue." *Perry*, 482 U.S. at 493 n.9; *Doctor's Assocs.*, 517 U.S. at 687. The court below ruled that the Agreement was unconscionable because Circuit City had failed to compare the relative "disadvantages" of "arbitration" to the advantages of litigation. That ruling impermissibly creates an arbitration-specific rule to assess the enforceability of arbitration agreements in direct contravention of this Court's decisions in *Perry* and *Doctor's Associates*. Moreover, the ruling below conflicts with the Third Circuit's recent decision explaining that the FAA imposes substantial limitations on the application of state unconscionability law to rewrite or strike down agreements to arbitrate.

I. THE DECISION BELOW IMPLICATES A DEEP CONFLICT ON WHETHER A COURT MAY REFUSE TO ENFORCE THE TERMS OF AN AGREEMENT TO ARBITRATE BASED ON STATE POLICIES THAT DO NOT APPLY TO "ANY CONTRACT."

Review should be granted because the decision of the California Supreme Court conflicts directly with a series of federal circuits on the question whether state-law policies other than those that apply to "any contract" may preclude enforcement of the terms of an agreement to arbitrate. 9 U.S.C. § 2.

a. On one side of the legal divide are federal circuit courts that follow the language of Section 2 of the FAA, which requires that arbitration agreements "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of *any contract*." 9 U.S.C. § 2 (emphasis added). These courts hold that state law that applies only to some, but not all, contracts, cannot defeat an agreement to arbitrate. See *Bradley* v. *Harris Research, Inc.*, 275 F.3d 884, 889-90 (9th Cir. 2001);

Stawski Distrib. Co. v. *Browary Zywiec S.A.*, 349 F.3d 1023, 1024-26 (7th Cir. 2003); *OPE Int'l LP* v. *Chet Morrison Contractors, Inc.*, 258 F.3d 443, 447 (5th Cir. 2001) (per curiam); *KKW Enters., Inc.* v. *Gloria Jean's Gourmet Coffees Franchising Corp.*, 184 F.3d 42, 50-51 (1st Cir. 1999); *Doctor's Assocs., Inc.* v. *Hamilton*, 150 F.3d 157, 163 (2d Cir. 1998); *cf. Management Recruiters Int'l* v. *Bloor*, 129 F.3d 851, 856 (6th Cir. 1997).

In *Bradley*, the Ninth Circuit held that Section 2 of the FAA preempted a state statute that would have blocked enforcement of an arbitration agreement because the statute applied only to franchise agreements. 275 F.3d at 890. *Bradley* reasoned that, under Section 2 of the FAA, "only state law that addresses the enforcement of 'contracts generally' is not preempted by the FAA." *Id.* at 889 (quoting *Doctor's Assocs.*, 517 U.S. at 687) (quotation marks omitted). Relying on decisions of the First, Second, Fifth, and Sixth Circuits, the Ninth Circuit held that the franchise statute "does not apply to 'any contract,'" and therefore was preempted by the FAA. *Id.* at 890 (quoting 9 U.S.C. § 2).

In *Bradley*, appellees contended–like the California Supreme Court in this case–that the state statute was not preempted "because it treats arbitration and litigation equally and does not single out arbitration as a disfavored form of dispute resolution." *Id.* at 889. The Ninth Circuit rejected that argument, holding that "only state law that addresses the enforcement of 'contracts generally' is not preempted by the FAA." *Id.* (quoting *Doctor's Assocs.*, 517 U.S. at 686-87). As *Bradley* explained, even if a state statute places arbitration on "equal footing" with litigation, it is preempted by the FAA if it is not generally applicable to all contracts. *Id.*; see *also*

Ting v. *AT&T*, 319 F.3d 1126, 1147-48 (9th Cir. 2003) (FAA preempts requirement in California's Consumer Legal Remedies Act (CLRA) that precluded waiver of class actions).

Likewise, the Fifth Circuit applied this same reasoning in *OPE International LP*, 258 F.3d 443. There, appellant argued that the arbitration agreement in question was invalid under a Louisiana statute applicable to construction contracts. The Fifth Circuit disagreed, holding that a state law that puts "a requirement" on arbitration clauses "not applicable to contracts generally" is preempted by Section 2 of the FAA. *Id.* at 447. The Fifth Circuit held that the state "'statute directly conflicts with § 2 of the FAA because the State's law conditions the enforceability of arbitration agreements on compliance with a . . . requirement not applicable to contracts generally.'" *Id.* (quoting *Doctor's Assocs.*, 517 U.S. at 687) (alteration omitted).

To the same effect is *KKW Enterprises, Inc.*, 184 F.3d 42. There, the First Circuit held that a state statute applicable only to franchise contracts was preempted by Section 2 of the FAA because it "does not apply to all contracts and does not establish a generally applicable contract defense." *Id.* at 52. The First Circuit reasoned that only state statutes that apply to "any contract" are consistent with the FAA. *Id.* at 50-51. That is, state statutes that apply only to one type of contract do not set forth "a generally applicable contract defense" and are therefore preempted by the FAA. *Id.* at 51.

Similarly, in *Doctor's Associates*, 150 F.3d 157, the Second Circuit held that Section 2 of the FAA preempted state law applicable only to franchise contracts because the law "did not establish a generally applicable contract defense that applies to

any contract." *Id.* at 163 (quotation marks omitted). Instead, the law simply "invalidated a franchise agreement's forum selection clause under the New Jersey Franchise Practices Act." *Id.* The Court noted that its holding meant that "state law" would play a more "narrow role . . . in FAA jurisprudence," *id.* at 162, but that precise result was mandated by the "FAA's strong policy in favor of rigorously enforcing arbitration agreements." *Id.*

Further, in *Stawski Distributing*, 349 F.3d 1023, the Seventh Circuit overturned the district court's order denying a "stay [of] litigation in favor of arbitration" and held that state law governing contracts between "brewers and distributors" was preempted because it did not apply generally to all contracts. *Id.* at 1024-25. The Seventh Circuit explained that the FAA "disables states from subjecting arbitration to rules that are not generally applicable to other contract choices," and therefore the result mandated by the FAA under these facts was that the state law was preempted and the arbitration must continue. *Id.* at 1025.

Taken together, these cases establish that five federal circuit courts have applied the unambiguous language of Section 2 of the FAA to hold that courts may not refuse to enforce agreements to arbitrate based on state-law grounds other than "grounds that exist at law or in equity for the revocation of *any* contract." 9 U.S.C. § 2. Under the majority view, state law applicable to a limited set of contracts cannot, consistent with the FAA, provide a basis for refusing to enforce the terms of an agreement to arbitrate.

b. In conflict with the majority rule is the decision below as well as decisions by the Montana and Washington Supreme Courts. These courts have

invalidated arbitration agreements based on state law applicable only to a narrow subset of contracts and sought to support that result by noting that they apply the same or similar standards to non-arbitration agreements.

In the decision below, the California Supreme Court held that the enforceability of an agreement to arbitrate individually depends on a determination whether individual arbitration was consistent with state labor law policy. Pet. App. 23a. The Court further held that the state labor law is not preempted by the FAA, even though such policies are not applicable to contracts generally but only to labor contracts. *Id.* at 26a-29a. The California Supreme Court reasoned that its ruling was not preempted because it was "arbitration-neutral," *i.e.*, it treated contracts that called for litigation and arbitration the same. *Id.* at 27a.

In a similar vein, the Washington Supreme Court in *Scott* v. *Cingular Wireless*, 161 P.3d 1000 (Wash. 2007), invalidated an arbitration agreement based on a state law applicable to consumer contracts. *Id.* at 1008-09. Plaintiffs brought suit to invalidate an arbitration clause limiting class action arbitration, *id.* at 1002-03, and argued that the arbitration clause violated the state consumer protection act, which by its terms applies only to consumer contracts. *Id.* at 1005. The Washington Supreme Court invalidated the arbitration agreement because it concluded that individual arbitration was contrary to the state consumer protection law. *Id.* at 1008.[3]

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[3] *See Wisconsin Auto Title Loans, Inc.* v. *Jones*, 714 N.W.2d 155, 177-78 (Wis. 2006) (stating, in dicta, that FAA "preempts only those laws that target arbitration specifically while

In *Keystone, Inc. v. Triad Systems Corp.*, 971 P.2d 1240 (Mont. 1998), the Montana Supreme Court held that state law applying to contracts with arbitration clauses was not preempted by the FAA because it did not place arbitration agreements on "unequal footing." *Id.* at 1245 (internal quotation marks omitted). The *Keystone* Court examined the validity of an arbitration clause that required out-of-state arbitration against two Montana state statutes that required such disputes to be resolved within Montana. One statute applied to contracts that contained no arbitration clauses, while the other applied to contracts with arbitration clauses. *Id.* at 1244 ("'No agreement concerning venue . . . is valid unless the agreement requires that arbitration occur within the state of Montana.'") (quoting Mont. Code Ann. § 27-5-323). The Montana Supreme Court held that the arbitration-specific statute was not preempted by the FAA, *id.* at 1244-45, and rested its holding on the fact that even though the state arbitration law did not apply generally to "any contract," Montana law ultimately treated arbitration and litigation in the same manner. *Id.*[4]

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preserving through the savings clause state laws affecting contracts").

[4] Scholars likewise have acknowledged this conflict over the appropriate scope of the FAA. *Compare* Jean R. Sternlight, *The Rise and Spread of Mandatory Arbitration as a Substitute for the Jury Trial*, 38 U. San Fran. L. Rev. 17, 36-38 (2003) (arguing for narrow view of FAA preemption), *with* Christopher R. Drahozal, *Federal Arbitration Act Preemption*, 79 Ind. L.J. 393, 409 (2004) ("Lower courts are split on whether" statutes that govern only specific types of contracts "fall under the saving clause and avoid preemption."), *and* Stephen Hayford & Alan Palmiter, *Arbitration Federalism: A State Role in Commercial Arbitration*, 54 Fla. L. Rev. 175, 177 (2002) (discussing FAA preemption and noting that there "lies a murky sphere (a kind

c. Review is warranted in this case to resolve this fundamental conflict among the lower courts over the proper application of the FAA on issues that affect the rights of countless individuals and businesses across the country.

Under the majority rule, the FAA mandates the enforcement of agreements to arbitrate, in accordance with their terms, save upon grounds available for the revocation of "any contract." 9 U.S.C. § 2. In those cases, the lower courts hold that the FAA does not allow them to refuse to enforce agreements to arbitrate based upon narrow state policies such as: (i) franchise law (*Bradley*, 275 F.3d at 889-90 (9th Cir.); *Doctor's Assocs.*, 150 F.3d at 163 (2d Cir.); *KKW Enters.*, 184 F.3d at 51-52 (1st Cir.)); (ii) construction law (*OPE Int'l*, 258 F.3d at 447 (5th Cir.)); (iii) consumer law (*Ting*, 319 F.3d at 1147-48 (9th Cir.)); and (iv) brewer and distributor law (*Stawski*, 349 F.3d at 1024 (7th Cir.)).

These decisions closely follow this Court's decisions holding that California franchise and labor law do not provide a basis for refusing to enforce an agreement to arbitrate. See *Southland Corp.* v. *Keating*, 465 U.S. 1, 16 n.11 (1984) ("[T]he defense to arbitration found in the California Franchise Investment Law is not a ground that exists in law or at equity 'for the revocation of *any* contract'"); *Perry*, 482 U.S. at 490-91 (1987) (FAA preempts California state policy that required litigation of labor disputes). Indeed, in *Perry*, this Court struck down a California statute that precluded arbitration in cases involving labor disputes. This Court explained that, under the

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of boundary) where the FAA speaks, but without the same clarity and force as in the legislation's provisions on enforceability and arbitrability").

Supremacy Clause, California's requirement that "litigants be provided a judicial forum for resolving wage disputes" "must give way" to the FAA's requirement that arbitration agreements "be 'rigorously enforce[d].'" *Id.* at 490, 491 (quoting *Dean Witter Reynolds Inc.* v. *Byrd*, 470 U.S. 213, 221 (1985)). This Court explained that the FAA constrained state law "whether of legislative or *judicial origin*," because otherwise a court could "effect what we hold today the state legislature cannot." *Id.* at 492 n.9 (emphasis added).

In stark contrast, the decision below holds that enforcement of the terms of an agreement to arbitrate can be denied based on state law policies applicable not to "any contract" but based on California labor law. Pet. App. 1a, 23a. Here, the California Supreme Court made enforcement of the terms of the parties' agreement to arbitrate contingent on an assessment whether the individual arbitration agreed to by the parties is consistent with labor law. Enforcement is thus made to depend on matters such as (i) "the potential for retaliation," (ii) the possibility that "members of the class may be ill informed about their rights," and (iii) "other real world obstacles to the vindication of class members' right to overtime pay through individual arbitration." *Id.* at 23a.

Such a broad and sweeping limitation of the federal policy mandating enforcement of arbitration agreements is a far cry from the specific textual grounds set forth in Section 2 of the FAA and fundamentally inconsistent with "Congress's clear intent . . . to move the parties to an arbitrable dispute out of court and into arbitration as quickly and easily as possible." *Moses H. Cone Mem'l Hosp.* v. *Mercury Constr. Corp.*, 460 U.S. 1, 22 (1983). Further, the open-ended analysis of potential impact on third parties is flatly

contrary to this Court's precedent that the FAA requires (i) "an expeditious and summary hearing, with only restricted inquiry into factual issues," *id.*, and (ii) that, under the FAA, "an arbitration agreement must be enforced notwithstanding the presence of other persons who are parties to the underlying dispute but not to the arbitration agreement," *id.* at 20; see *Dean Witter*, 470 U.S. at 221 (FAA "*requires* piecemeal resolution when necessary to give effect to an arbitration agreement").

Further, the California Supreme Court squarely rejected the argument that the federal "policy in favor of enforcing arbitration agreements as written overrides the statutory policy in favor of vigorously enforcing overtime laws." Pet App. 28a n.8. That judge-made preference for state-law labor law over binding federal law violates the Supremacy Clause of the United States Constitution. Indeed, the California Supreme Court's preference for narrow state law policies as a basis for undoing private agreements to arbitrate is indistinguishable from the impermissible policies adopted by the California legislature that this Court held were preempted by the FAA. See *Southland*, 465 U.S. at 10-11; *Perry*, 482 U.S. at 491.[5] In effect, the California Supreme Court has, through judicial decision, refused to enforce the terms of an agreement to arbitrate based on the same narrow state law grounds that this Court rejected when attempted by the California legislature. *Id.* at 492-93 & n.9.

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[5] The court below sought to distinguish *Perry*, arguing that it stands solely for the proposition that "the FAA does not permit states to legislatively prohibit arbitration of wage disputes." Pet. App. 29a n.8. The *Perry* Court, however, made clear that the FAA preempted state law "whether of legislative or judicial origin." 482 U.S. at 492 n.9.

The California Supreme Court's conclusion that its ruling is not preempted by the FAA because it was refusing to enforce the parties' agreement in an "arbitration-neutral manner," Pet. App. 29a n.8, is precisely the argument that the federal circuit courts applying the majority rule have rejected. Thus, the Ninth Circuit in *Bradley* held that the FAA preempted California law that "affect[ed] both arbitration and litigation" because it did not apply to "contracts generally." 275 F.3d at 889. A contrary rule would allow courts to show hostility to arbitration by altering the "arbitral terms to which the parties agreed . . . into something more and more like the court litigation arbitration is intended to avoid." Pet. App. 52a (Baxter, J., dissenting).

Lastly, the enforceability of arbitration clauses governed by the FAA should not depend on geography under any circumstances. But the decisional conflict is particularly acute here where the outcome will vary depending on whether the litigation arises in federal court on one side of the street (and therefore will be governed by the Ninth Circuit's rule in *Bradley*) or is brought on the other side (and is thus subject to California's rule in *Gentry*). This is an intolerable situation and the Court should grant certiorari to eliminate the race to the courthouse that no doubt will be engendered.

II. THE UNCONSCIONABILITY RULING IN THE DECISION BELOW CONFLICTS WITH DECISIONS OF THIS COURT AND THE THIRD CIRCUIT.

Review also should be granted because the California Supreme Court's "unconscionability" ruling conflicts both with this Court's decisions and implicates a conflict among the federal circuits.

a. In *Perry*, this Court ruled that a court may not avoid the preemptive effect of the FAA through "[a] state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue." *Perry*, 482 U.S. at 493 n.9. Thus, "in assessing the rights of litigants to enforce an arbitration agreement," a court may not "construe that agreement in a manner different from that in which it otherwise construes nonarbitration agreements under state law" or "rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable." *Id.*

Following *Perry*, this Court in *Doctor's Associates* examined a state-law rule that made agreements to arbitrate unenforceable unless "'notice that [the] contract is subject to arbitration [is] typed in underlined capital letters on the first page of the contract.'" 517 U.S. at 684. This Court held that the Montana law was preempted by the FAA because the State's "first-page notice requirement" applied "specifically and solely" to "contracts 'subject to arbitration'" and not to "'any contract.'" *Id.* This Court reasoned that Montana law was displaced because it "conditions the enforceability of arbitration agreements on compliance with a special notice requirement not applicable to contracts generally." *Id.* at 687.

b. The California Supreme Court's unconscionability ruling conflicts with *Perry* and *Doctor's Associates* because it impermissibly imposes requirements governing the enforceability of the terms of agreements to arbitrate that are not applicable to non-arbitration agreements.

First, the court below concluded that the agreement to arbitrate was procedurally unconscionable—

despite a 30-day period during which Gentry could have opted out without any adverse consequence—because Circuit City "did not mention any of the additional significant disadvantages that *this particular arbitration agreement* had compared to litigation." Pet. App. 37a.

An arbitration-specific requirement that an individual be specifically provided an explanation of the "disadvantages" of arbitration as compared to litigation is precisely what this Court has confirmed the FAA precludes: "Nor may a court rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable." *Perry*, 482 U.S. at 492 n.9. To be clear, there is no question that Circuit City disclosed the rules governing arbitration. Indeed, the court below acknowledged that "an employee who read Circuit City's nine-page single-spaced document entitled Circuit City's 'Dispute Resolution Rules and Procedures' would have encountered" the provisions governing the parties' arbitration. Pet. App. 38a. What the court below required—and what the FAA prohibits—is an additional arbitration-specific obligation to disclose every possible way in which the rules of arbitration might be deemed "less favorable to an employee than those operating in a judicial forum." *Id.*

The standard applied by the California Supreme Court likewise conflicts with *Doctor's Associates* because the court below interposed an obligation—*i.e.*, to catalog all of the potential disadvantages of arbitration when compared to litigation – that applies solely to agreements to arbitrate and not to nonarbitration agreements. 517 U.S. at 687 ("Courts may not . . . invalidate arbitration agreements under state laws applicable *only* to arbitration provisions.").

Indeed, the court below nowhere suggested any parallel obligation for nonarbitration agreements to identify the *disadvantages* of litigation as compared to arbitration. As such, the California Supreme Court improperly "'requir[ed] greater information . . . in the making of agreements to arbitrate than in other contracts.'" *Id.* (citation omitted).

The California Supreme Court's ruling is particularly pernicious because *every* arbitration agreement can be deemed procedurally unconscionable based upon the grounds advanced by the decision below. As noted, at its core, arbitration is beneficial because it provides individuals with an alternative to litigation: "[B]y agreeing to arbitrate, a party 'trades the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration.'" *Gilmer* v. *Interstate/Johnson Lane Corp.*, 500 U.S. 20, 31 (1991). Under the ruling below, an arbitration agreement would be deemed procedurally unconscionable based solely on a failure to anticipate, in an explanatory handbook, each and every possible disadvantage of arbitration as compared to litigation. Such a ruling would cripple the ability of parties to choose arbitration as an alternative to litigation, a choice that "may be of particular importance in employment litigation, which often involves smaller sums of money than disputes concerning commercial contracts." *Circuit City Stores, Inc.* v. *Adams*, 532 U.S. 105, 123 (2001).

The California Supreme Court also speculated that "it is not clear that someone in Gentry's position would have felt free to opt out" because "Circuit City preferred that the employee participate in the arbitration program." Pet. App. 39a. Under California law, however, the party opposing enforce-

ment of a contract has the affirmative burden of proving unconscionability. *E.g.*, *Brutoco Eng'g & Constr., Inc.* v. *Superior Court*, 107 Cal. App. 4th 1326, 1331 (2003). Here, "Gentry signed an easily readable, one-page form that accompanied receipt of the Associate Issue Resolution Package," which explained the procedures if he wanted to *opt out* of arbitration with Circuit City. Pet. App. 32a-33a. The majority cited no support for its novel view that where an employer has a preference for *arbitration*, its employees (even if offered an opt out) will be deemed to have been coerced into agreeing to arbitrate. To the contrary, the law is settled that "[m]ere inequality in bargaining power . . . is not a sufficient reason to hold that arbitration agreements are never enforceable in the employment context." *Gilmer*, 500 U.S. at 33.[6]

c. The California Supreme Court's unconscionability ruling also conflicts with the Third Circuit's decision in *Gay* v. *CreditInform*, ___ F.3d ___ 2007

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[6] *See* Michael G. McGuinness & Adam J. Karr, *California's "Unique" Approach to Arbitration: Why This Road Less Traveled Will Make All the Difference on the Issue of Preemption Under the Federal Arbitration Act*, 2005 J. Disp. Resol. 61, 62 (2005) ("California has created a new brand of unconscionability. It is far more demanding—and it is unique to arbitration."); Susan Randall, *Judicial Attitudes Toward Arbitration and the Resurgence of Unconscionability*, 52 Buff. L. Rev. 185, 186 (2004) ("[J]udges find unconscionable specific features of arbitration agreements, such as forum selection clauses and confidentiality requirements, which are routinely enforced as unobjectionable in nonarbitration agreements"); Stephen J. Ware, *Arbitration and Unconscionability After* Doctor's Associates, Inc. v. Casarotto, 31 Wake Forest L. Rev. 1001, 1034 (1996) ("Judicial decisions apply unconscionability, and other common law doctrines, more aggressively to arbitration agreements than to other contracts.").

WL 4410362 (3d Cir. Dec. 19, 2007).[7] In *Gay*, the Third Circuit applied this Court's decision in *Perry* and explained that the FAA "distinguished state law principles that apply to contracts generally from those that are unique to arbitration agreements." *Id.* at *20. The *Gay* Court ruled that an agreement to arbitrate a consumer dispute as a class action was enforceable even if such an agreement would be deemed "unconscionable" as a matter of Pennsylvania decisional law.

The Third Circuit rejected the argument that Pennsylvania unconscionability law was insulated from further scrutiny under the FAA. *Id.* The Third Circuit instead concluded that the "unconscionability" rulings under Pennsylvania law would be preempted by the FAA because those rulings "deal with agreements to arbitrate, rather than with contracts in general." *Id.* Specifically, the *Gay* Court explained that state-law "unconscionability" rules were preempted when they "rel[y] on the uniqueness" of the arbitration provision. *Id.*

The Third Circuit's decision is in direct conflict with the decision below, because the California Supreme Court's unconscionability analysis centered on the fact that an agreement to arbitrate was at issue. The court below adopted an unconscionability standard based upon arbitration-specific rules that, by their terms, do not apply to nonarbitration contracts. In

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[7] *Accord Iberia Credit Bureau, Inc.* v. *Cingular Wireless LLC*, 379 F.3d 159, 167 (5th Cir. 2004) ("Even when using doctrines of general applicability, state courts are not permitted to employ those general doctrines in ways that subject arbitration clauses to special scrutiny."); *Banc One Acceptance Corp.* v. *Hill*, 367 F.3d 426, 432 (5th Cir. 2004) (same).

stark contrast, the Third Circuit has explained that such rules are preempted by the FAA.

The need to resolve this conflict is even more pressing now that the Ninth Circuit has considered the issue and declined "to follow the holding in *Gay*." *Lowden* v. *T-Mobile USA, Inc.*, ___ F.3d ___, 2008 WL 170279, at *8 n.3 (9th Cir. Jan. 22, 2008).

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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